Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

No. 75-1381

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

GERALD F. PADUANO, et al.,

Petitioners

— v. —

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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PETITIONERS' REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

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On pages 3 and 4 of Respondent's Memorandum in Opposition, Respondent argues that Stonehedge and Seneca "paid interest to other third party creditors during the period in question". However, the record is very clear that the three related companies involved, Stonehedge, Seneca and Cappy's, could not borrow money from banks in order to meet their obligations and that CCP had to make additional advances to these companies to pay interest to third party creditors and to prevent foreclosure by first mortgagees. (R. 122, 123)

Also on page 4 Respondent argues that financial inability to pay interest should not be a factor in a Section 482 allocation. Therefore, according to Respondent's reasoning, a related

party obligee would be required to pay an income tax on interest income that it could not receive nor reasonably expect to receive. But in the same factual situation, had the parties been non-related, the non-related party obligee would not have to pay an income tax. In effect Respondent is advocating that the tax law should discriminate against related parties and impose a greater tax burden on them than on non-related parties, (in a similar situation).

The various Courts of Appeal cited in taxpayer's Petition concerning the Section 482 issue have stated that related parties should deal with each other at arm's length and should be treated as non-related parties with respect to loan transactions. Respondent's position is that this same non-related party standard should not be applied when the collection of interest income is remote. Thus, under the same factual setting, concerning loan transactions, Respondent would have the court apply a double standard in the imposition of income taxes; one for non-related parties and another for related parties.

Respondent also argues on page 4 that "it would be a relatively simple matter to arrange (financial) inability in advance of an interest free loan". Respondent gives no example as to how the arrangement of the obligor's financial inability would take place. But, one wonders whether Respondent is implying that the related obligors should put itself on the verge of bankruptcy or commit some other imprudent business transaction merely to avoid paying the interest obligation under Section 482 to its related obligee.

It is respectfully submitted that Respondent has not adequately contested the issue raised, therefore, the petition for Writ of Certiorari should be granted.

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